

## Message Text

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ACTION EUR-12

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TAGS: ECON, OECD

SUBJECT: ECONOMIC AND DEVELOPMENT COMMITTEE (EDRC)

REVIEW OF SWEDEN, MARCH 8

REF: EDR(76)5

1. SUMMARY: DURING MARCH 8 EDRC REVIEW OF SWEDEN SECRETARIAT EMPHASIZED SWEDISH SUCCESS IN MAINTAINING FULL EMPLOYMENT DURING 1975, AND ATTRIBUTED PERFORMANCE LARGELY TO INVENTORY ACCUMULATION SUBSIDIES (SEE PARA 2) AND OPERATIONS OF INVESTMENT FUND SCHEME. SWEDISH DEL (LED BY ABERG, FINANCE MINISTRY) AGREED, AND ADDED THAT PROGRAMS SUBSIDIZING MARGINAL COST OF LABOR WERE EQUALLY IMPORTANT. EDRC CHAIRMAN (HUET) AND SOME DELS WERE SOMEWHAT SKEPTICAL OF SWEDISH ABILITY TO DEFY THE CYCLE DURING 1976, FELT THAT RECESSION'S IMPACT MIGHT JUST HAVE BEEN POSTPONED, AND THAT FINAL EVALUATION SHOULD AWAIT END OF THIS YEAR. SWEDES ACKNOWLEDGED THAT 1976 CARRIED DOWNSIDE RISKS, THAT CONTINUED SUCCESS DEPENDED

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ON STRONG 1976 EXPORT GROWTH, AND THAT THEY STOOD READY

TO INTERVENE WITH ADDITIONAL SELECTIVE MEASURES IF EMPLOYMENT OUTLOOK WERE SERIOUSLY TO DETERIORATE. SWEDES ALSO SUPPORTED EDRC VIEW THAT DANGER OF COST/PRICE SPIRAL EXISTS AND THAT CONTROL OF WAGES WAS ESSENTIAL TO REDUCE INFLATION AND TO MAINTAIN SWEDISH COMPETITIVE POSITION. NEITHER SWEDES NOR SECRETARIAT FELT 1976 CURRENT DEFICIT WOULD POSE FINANCING PROBLEMS, BUT STRESSED THAT MOUNTING EXTERNAL DEBT ARGUED FOR PROGRESSIVE RETURN TO CURRENT ACCOUNT BALANCE BY 1980. END SU

2. SHORT-TERM OUTLOOK; DOMESTIC PROSPECTS: SECRETARIAT EMPHASIZED SWEDISH SUCCESS IN RIDING OUT RECENT RECESSION WITHOUT INCREASE IN UNEMPLOYMENT, AND ATTRIBUTED SWEDISH PERFORMANCE DURING 1975 TO INVENTORY ACCUMULATION SUBSIDIES (WHICH WERE USEFULLY TIED TO MAINTENANCE OF EMPLOYMENT) AND TO OPERATIONS OF INVESTMENT FUND SCHEMES UNDER WHICH CONTRIBUTIONS PAID INTO FUND BY FIRMS IN 1974 WERE RELEASED ONLY IF THEY DEMONSTRATED THAT NEW INVESTMENT WAS TAKING PLACE. SWEDES NATURALLY AGREED WITH SECRETARIAT ASSESSMENT, AND ADDED THAT PROGRAMS SUBSIDIZING MARGINAL COST OF LABOR (RETRAINING SUBSIDIES AND OTHER SUBSIDIES FOR NEW LABOR MARKET ENTRANTS) WERE EQUALLY IMPORTANT IN MAINTAINING EMPLOYMENT. SWEDES STRESSED THAT STIMULATORY PROGRAMS WERE DESIGNED SPECIFICALLY TO INCREASE DEMAND FOR LABOR (AT CONSTANT WAGE RATES) RATHER THAN TO INCREASE AGGREGATE DEMAND GENERALLY, AND HAD THE FURTHER OBJECTIVES OF MAXIMIZING GOVERNMENT CONTROL OF SPENDING DECISIONS AND MINIMIZING EFFECT ON IMPORT GROWTH.

3. EDRC CHAIRMAN (HUET) AND SOME DELS FELT THAT LARGE INVENTORY OVERHANG WAS PRODUCED IN 1976. THIS, AND POSSIBLE DECLINE IN FIXED INVESTMENT (DUE TO POOR LIQUIDITY POSITION OF FIRMS) COULD LEAD TO WEAK DEMAND IN 1976, AND THAT THUS EFFECT OF SWEDISH POLICY IN 1975 MIGHT HAVE BEEN TO POSTPONE, RATHER THAN ELIMINATE, THE EFFECTS OF RECESSION. SWEDES ACKNOWLEDGED THAT THERE WERE DOWNSIDE RISKS FOR 1976, AND THAT THEY WERE COUNTING PRIMARILY ON STRONG RESURGENCE OF EXPORTS TO PULL THEM THROUGH. THEY ADDED, HOWEVER, THAT LIQUIDITY OF LIMITED OFFICIAL USE

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FIRMS ACTUALLY INCREASED BY 20 PERCENT BETWEEN FOURTH QUARTER 1975 AND FOURTH QUARTER 1974, THAT RECENT INCREASE IN SHARE OF WAGES IN FIRMS' VALUE ADDED WAS ACTUALLY RETURN TO "NORMAL" AFTER 1973-74 PROFIT EXPLOSION, AND THAT LIQUIDITY POSITION OF FIRMS HAD NOT DETERIORATED TO A DEGREE WHICH WOULD PRODUCE THE 1.5 PERCENT DECLINE IN 1976 MANUFACTURING INVESTMENT FORECAST BY SECRETARIAT. (SWEDES PROLECT ZERO GROWTH, BUT

NO DECLINE IN 1976 INVESTMENT VOLUMES.) SWEDES ALSO  
ASSERTED THAT SOME SUPPORT OF DOMESTIC ACTIVITY MIGHT  
PROVE NECESSARY EVEN IF EXPORT GROWTH IS STRONG' AND  
STATED INTENTION APPLYING ADDITIONAL SELECTIVE EMPLOY-  
MENT-CREATING MEASURES AS NECESSARY IN 1976. IF REAL  
GDP GROWTH FALLS FAR SHORT OF CURRENT SWEDISH EXPECTA-  
TIONS (1.5 PERCENT), THEY STAND READY TO COMPLETELY

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REEVALUATE POLICY STANCE.

4. COSTS AND PRICES: SECRETARIAT UNDERSCORED POSSI-  
BILITY OF ACCELERATED WAGE/PRICE SPIRAL AS CLEAR AND  
PRESENT SHORT-TERM DANGER, ESPECIALLY IN LIGHT OF CURRENT  
ACCOUNT DEFICIT AND ADVERSE EFFECTS OF INCREASED PRICES  
AND COSTS ON SWEDISH COMPETITIVE POSITION. SWEDES NOTED  
THAT LITTLE COULD BE DONE TO CONTROL WAGES IN 1976,  
SINCE INCREASES HAVE ALREADY BEEN DETERMINED BY 1974  
WAGE AGREEMENTS. THEY NOTED THAT SOME EXPANSION OF  
PRICE CONTROL POLICY IS POSSIBLE DURING YEAR, AND THEY

EXPECT 1976 INCREASE IN CONSUMER PRICES (10 PERCENT) TO BE CLOSE TO AVERAGE OECD-WIDE PERFORMANCE PROJECTED BY SECRETARIAT, AND THEREFORE IMPLY ONLY MINIMAL WORSENING OF THEIR COMPETITIVE POSITION. SWEDES ADDED, HOWEVER, THAT COST/PRICE OUTLOOK FOR 1977 AND 1978 WOULD BE BLEAK UNLESS NOMINAL WAGE INCREASES ARE CONTROLLED IN NEXT WAGE ROUND BEGINNING JANUARY 1977, WHEN 1977-78 WAGE INCREASES WILL BE SET. THEY STATED GOS INTENTION TO HOLD DOWN WAGE INCREASES BY INCREASING LABOR'S DISPOSABLE LIMITED OFFICIAL USE

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INCOME THROUGH REDUCTIONS IN DIRECT TAXES, BUT DECLINED TO GO INTO FURTHER DETAIL BEFORE GOVERNMENT POLICY IS PRESENTED PUBLICLY AT END OF APRIL, 1976. SECRETARIAT NOTED THAT LARGE PROFIT AND WAGE INCREASES IN RELATIVELY MORE PRODUCTIVE EXPORT SECTOR COULD HAVE RIPPLE EFFECTS ON OTHER LESS PRODUCTIVE SECTORS AND COULD HAVE STRONG COST-PUSH INFLUENCE. SWEDES RECOGNIZED PROBLEM, BUT DID NOT GO INTO POSSIBLE SOLUTIONS.

5. CURRENT ACCOUNT: SWEDES FORECAST 6-7 PERCENT INCREASE IN WORLD TRADE IN 1976 AND CORRESPONDING INCREASE IN SWEDEN'S EXPORT VOLUMES COMPARED WITH SECRETARIAT FORECAST OF 3.5-6.5 PERCENT INCREASE. SWEDES DEFENDED THEIR ESTIMATES BY NOTING THAT LARGE STOCKS WOULD ALLOW THEM QUICKLY TO RESPOND TO FOREIGN DEMAND. SECRETARIAT DID NOT DISAGREE. SWEDES SEE SOME INCREASE IN 1976 IMPORT VOLUMES, WHILE SECRETARIAT PROJECTS SMALL FALL (-1 TO 1.5 PERCENT). SINCE BOTH EXPECT NO CHANGE IN TERMS OF TRADE AND DEFICIT ON INVISIBLES TRANSACTIONS, SWEDES PROJECT A LARGER CURRENT ACCOUNT 1976 DEFICIT (6.2 BILLION KRONER) THAN DOES SECRETARIAT (4-5 BILLION KRONER). SWEDES NOTED THAT THEIR "CYCLICALLY ADJUSTED" CURRENT ACCOUNT DEFICIT WAS ONLY HALF THE ACTUAL AMOUNT THEY FORESEE FOR 1976 AND THAT NO FINANCING PROBLEMS ARE EXPECTED, BUT THAT DEBT ACCUMULATION COULD BECOME SERIOUS OVER MEDIUM TERM. GOS POLICY WAS TO RETURN TO CURRENT ACCOUNT BALANCE BY 1980. NORWEGIAN DEL SUGGESTED THAT DEVALUATION OF SWEDISH KRONER IN 1976 WOULD HASTEN RETURN TO BALANCE. SWEDES REJECTED DEVALUATION, ARGUING THAT RESULTING INCREASE IN DOMESTIC PRICES WOULD LEAVE LABOR WITH SMALLER INCREASE IN REAL INCOME THAN THEY HAD BEEN LED TO EXPECT IN 1974, AND WOULD THUS JEOPARDIZE SUCCESS OF 1977 WAGE NEGOTIATIONS.

6. FISCAL AND MONETARY POLICY: DISCUSSION OF DEMAND MANAGEMENT POLICIES WAS MINIMAL AND CONFINED TO GENERAL STATEMENTS BY SWEDISH DEL THAT FISCAL POLICY EASE WOULD CONTINUE AND THAT MONETARY POLICY WOULD AIM AT FACILITATING FLOW OF FUNDS TO BUSINESS AND AT FINANCING BUDGET

DEFICIT WITHOUT PRODUCING EITHER CROWDING OUT OR  
EXCESSIVE MONETIZATION OF DEBT. OVERALL POLICY STANCE  
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FOR 1976 WILL BE CONSISTENT WITH SECRETARIAT RECOMMENDA-  
TION OF "WAIT AND SEE."

7. MEDIUM TERM: SEVERAL DELS POINTED TO ABSENCE OF  
MEDIUM-TERM POLICY ANALYSIS IN REFD. SECRETARIAT  
AGREED THAT REVISED SURVEY SHOULD INCLUDE SUCH AN  
ANALYSIS WHICH WOULD FOCUS ON NEED FOR GOS TO REDUCE  
ITS SHARE OF GDP AND TO RETURN TO CURRENT ACCOUNT  
BALANCE. SWEDEN REITERATED THAT MEDIUM-TERM REVIEW  
INCLUDED OBJECTIVE OF CURRENT ACCOUNT BALANCE, AND ADDED  
THAT IN VIEW OF NEED TO MAKE ROOM FOR EXPANSION OF BOTH  
EXPORTS AND PRIVATE CONSUMPTION, A FURTHER MEDIUM-TERM  
AIM WAS TO REDUCE GOVERNMENT SHARE OF GDP.

8. OVERALL CONCLUSION OF EDRC REVIEW WAS THAT SWEDEN  
HAD TURNED IN EXCELLENT PERFORMANCE IN 1975, THAT PROS-  
PECTS FOR 1976 WERE SOMEWHAT MORE PRECARIOUS, AND THAT  
POLICY FOR 1977 AND BEYOND SHOULD CONCENTRATE ON CONTROL  
OF WAGES AND PRICES AND ON IMPROVEMENT OF CURRENT  
ACCOUNT.  
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